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RESEARCH ARTICLE

FISCAL SYSTEM OF INDIAN STATE OF HIMACHAL PRADESH: CHALLENGES AND OPPORTUNITIES

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ABSTRACT

Fiscal system of the country has undergone a significant change over the years especially with respect to imbalance in fiscal system of states vis-à-vis centre. Small states like Himachal Pradesh are mostly reeling under fiscal imbalance due to increasing scope of government sector obligation and the Fiscal Responsibility Act 2004. Himachal Pradesh is one of the small states of India that despite limited public finances is doing well on various socio-economic fronts. But the fiscal situation in the state is deteriorating with each passing day. Even Special Category States' status has not recued it from financial hardship. This review paper analyzes the fiscal system of Himachal Pradesh for the better understanding of fiscal system and its challenges and opportunities.

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INTRODUCTION

Fiscal system of India is based on federal principles of a state. Therefore, there is a definite division of powers between central government and provincial (state) government. Transfers from Centre are recommended by various agencies including the Finance Commission, Planning Commission, and the central ministries (Srivastava and Rao, 2009). Over a period of time, the nature and scope of governments' function has changed manifold. Resultantly, this has also changed the expenditure and tax pattern of governments whether at centre level or at state level. As far as the fiscal system is concerned, Centre has become stronger over the period of time. High dependency of the states on central transfers has weakened accountability and fiscal discipline (Heredia-Ortiz and Rider, 2005). The situation in many states including Himachal Pradesh has become very poor with rising fiscal deficit. The situation became further complicated with the onset of important legislations limiting the state's expenditure and revenue base. Increasing salary bills after the revision of pay on the recommendation of Pay Commissions have further tightened the fiscal position of states. More recently, there is an increasing focus on Central Sponsored Schemes (CSS). In 2006-07, there were at least 151 centrally sponsored schemes (CSS), entailing an annual expenditures of about Rs.72,000 crore. Of this, almost 90 percent were allocated to thirty schemes (Kapur and Mukhopadhyay, 2007). Though this is positively catering to the developmental needs of state

finances but it is bringing-in new challenges in terms of some political and geographical point of view. This paper tries to analyze the fiscal system of Himachal Pradesh for its strength and limitations in fiscal system.

Economic background of Himachal Pradesh

Gross State Domestic Product (G.S.D.P.) or state income is the most important and basic indicator for knowing the state of economic development of the state. The total Gross State Domestic Product of the Pradesh at current prices was estimated at Rs. 43,281 crore in 2009-10 (GoHP, 2011). The State Gross Domestic Product (GSDP) at factor cost at constant (2004-05) prices in 2009-10 was estimated at Rs. 35,888 crore. The Per Capita Income at current prices was Rs.50,365 in 2009-10. At constant (2004-2005) prices the per capita income during 2009-10 was estimated at Rs.40,690. The share of primary sectors, which include agriculture, forestry, fishing and mining & quarrying was 20.74 percent during 2009-10 (Table 1). The Secondary sector, which now occupies an important place in the state economy, contributed 39.65 percent in 2009-10 which is highest among all three sectors. Tertiary sector which comprises sectors like trade, transport, communications, banking, real estate and business services, community and personal services was 39.61 percent. In monetary terms, the contribution of primary, secondary and tertiary sector is 6708, 15319 and 13861 crore rupees respectively (Table 2). Construction, which is a part of the secondary sector, is the single largest contributor of Rs. 8,353 crore to GSDP.

RESULTS

State of fiscal health

Himachal Pradesh is a special category state ever since it was conferred statehood in 1971. It has been dependent for financial viability on transfers from Government of India (GoI, 2005). Annual budget document depict the state of fiscal health of a state government. Taxation is one of the major sources of state revenue contributing about 45% of the revenue receipts. Sales tax is the largest contributing tax in the state with a share of 56% in total tax revenue in the year 2008-09 (Table 3).

State excise duty especially on liquor is the second largest contributor at about 20%. After the introduction of VAT, total revenue of Rs. 2,274.75 crore was mobilized during 2009-10 under all Acts administered by the Excise and Taxation Department. Out of total revenue collection, VAT collections accounted for Rs. 1,488.16 crore (65.42%) and collection under Excise Act was of Rs. 500.72 crore (22.01%). The balance revenue collections of 12.57 percent had been from HP PGT Act, HP Luxury Tax Act, HP CGCR Act, HP Entertainment Tax Act and HP Toll Tax Act. According to the budget estimates for the year 2010-11, the total revenue receipts increased by 9.98% to Rs. 11,588 crore from

Table 1. Sectoral Contribution in State Domestic Product (in percentage)

Year	Primary Sector	Secondary Sector	Tertiary Sector
1980-81	50.35	18.69	30.96
1990-91	35.10	26.50	38.40
2000-01	25.25	35.77	38.98
2009-10	20.74	39.65	39.61

Source: Economic Surveys (Issues relating to concerned year)

Table 2. Income from different sectors of economy in 2009-10 (Crore Rs.)

Primary Sector	Income Crore Rs.	Sectoral %
1. Agriculture & Animal Husbandry	4,582	68.31
2. Forestry & Logging	1,939	28.91
3. Fishing	42	0.63
4. Mining & Quarrying	145	2.16
Total Primary	6,708	100.00
Secondary Sector		
1. Manufacturing	3,867	25.24
2. Construction	8,353	54.53
3. Electricity, Gas & Water Supply	3,099	20.23
Total Secondary	15,319	100.00
Tertiary Sector		
1. Transport, Comm., Trade & Hotel	5,387	38.86
2. Finance & Real Estate	2,887	20.83
3. Community & Personal Services	5,587	40.31
Total Tertiary	13,861	100.00

Source: Compiled from Economic Survey 2010

Table 3. Revenue from Different State Taxes in 2008-09 (in Rs. Lakh)

Taxation Head	Revenue	% of total tax revenue
Land revenue	2027.59	0.90
Stamp and Registration & estate duty	9,833.23	4.38
Sales tax	1,24,630.99	55.58
State excise	43,182.96	19.26
Taxes on vehicles	13,552.99	6.04
Taxes on goods & passengers	6,239.26	2.78
Taxes & duty on electricity	7,882.67	3.52
Other taxes & duties on commodities & services	16,899.55	7.54
Total	2,24,249.24	100.00

Table 4. Receipt and Expenditure of the State Government in Budget 2010-11 and 2011-12 (BE in crore Rs.)

Sr. No.	Item	2010-11	2011-12
1	Revenue Receipts(2+3+4)	11588	14094
2	Tax Revenue	4590	6100
3	Non-Tax Revenue	1779	1995
4	Grant-in-aid	5219	5998
5	Revenue Expenditure	12093	14042
	(a) Interest Payments	2232	2151
6	Revenue Deficit (1-5)	(-) 505	(+) 51
7	Capital Receipts	3058	2627
	(a) Recovery of loans	26	24
	(b) Other receipts	759	550
	(c) Borrowings & liabilities	2273	2053
8	Capital Expenditure	2985	1498
	Total Receipts	14646	15591
	Total Expenditure	15078	16708

Source: Economic Survey (Govt. of H.P.) 2010-11

Table 5. Expenditure on Revenue Account of state government in 2010-11 and 2011-12 (BE in Rs. crore)

Head of Account	2010-11	% of Net Rev. Exp.	2011-12	% of Net Rev. Exp.
1.General Services:	5178.3	42.82	5752.26	40.96
(a) Organs of State	110.64	0.91	153.35	1.09
(b) Tax collection charges	155.67	1.29	201.19	1.43
(c) Other fiscal services	1.24	0.01	0.93	0.01
(d) Interest payments And Debt services	2232.20	18.46	2150.58	15.31
(e) Others	2678.55	22.15	3246.21	23.12
2.Social Services:	4229.69	34.98	5215.65	37.14
(a) Education, sports, art and culture	2429.95	20.09	3188.79	22.71
(b) Health and Family Welfare	654.75	5.41	822.86	5.86
(c) Water supply and sanitation	434.01	3.59	459.95	3.28
(d)Housing and Urban Development	147.23	1.22	134.03	0.95
(e) Social Welfare Services	416.03	3.44	429.79	3.06
(f) Others	147.72	1.22	180.23	1.28
3.Economic Services:	2681.96	22.18	3071.08	21.87
(a1) Co-operation	22.55	0.19	29.42	0.21
(a2) Agriculture*	510.75	4.22	640.42	4.56
(a3) Forests**	377.89	3.12	451.58	3.22
(b) Rural Development	311.47	2.58	474.42	3.38
(c) Irrigation & flood control	215.08	1.78	242.34	1.73
(d) Industry and Minerals	51.79	0.43	65.75	0.47
(e) Transport and Tourism	985.2	8.15	934.55	6.66
(f) Others	207.23	1.71	232.60	1.66
4.Grants-in-aid	3.47	0.03	3.47	0.02
NET REVENUE EXPENDITURE	12093.42	100.00	14042.46	100.00

* It includes Fisheries, Animal Husbandry; Cattle shed Development and Grain Storage etc.; ** It includes Soil Conservation and Plantation.
Source:-Finance Department, Himachal Pradesh.

Table 6. Expenditure on Capital Account of state government in 2010-11 and 2011-12 (BE in Rs. lakh)

Head of account	2010-11			2011-12		
	Gross Capital Expenditure	Recoveries	Net Capital Expenditure	Gross Capital Expenditure	Recoveries	Net Capital Expenditure
General Services	70.01	0.00	70.01	64.67	0.00	64.67
Social Services	583.77	0.00	583.77	360.81	0.00	360.81
Economic Services	1140.82	34.32	1106.50	1110.03	37.57	1072.46
Total	1794.60	34.32	1760.28	1535.51	37.57	1497.94

Table 7. Interest payments by state government over the years (Rs. in crore)

Year	Total Revenue Receipts	Interest Payments	Percentage of interest payments with reference to	
			Total Revenue Receipts	Revenue Expenditure
2002-03	3659	1172	32.03	22.80
2006-07	7835	1669	21.30	21.83
2010-11	11588	2232	19.26	18.46

Table 8. Himachal Pradesh's share in Central Taxes and Duties Recommended by the Finance Commissions

Finance Commission	Percentage share in taxes & duties	Percentage share in grants
First	0.00	0.0
Second	0.00	0.0
Third	0.00	0.0
Fourth	0.00	0.0
Fifth	0.49	3.9
Sixth	0.61	6.4
Seventh	0.57	13.4
Eighth	1.49	6.5
Ninth (1)	1.19	6.1
Ninth (2)	1.44	3.3
Tenth	1.81	5.0
Eleventh	0.68	8.3
Twelfth	0.52	7.9
Thirteenth	0.78	4.0

Rs. 10,536 crore in 2009-10. The state's own taxes were estimated at Rs. 2,955 crore in 2010-11 as against Rs. 2,603 crore in 2009-10. The state's non-tax revenue (comprising mainly of interest receipts, power receipts, road transport receipts and other administrative services etc.) was estimated

at Rs. 1,779 crore in 2010-11 which is about 15.35 percent of total revenue receipts (GoHPa, 2011). The share of central taxes was estimated at Rs. 1,635 crore in 2010-11. Analysis of the last two budgets of the state government mainly highlight a deficit of 500 crore in 2010-11 and a surplus of 55 crore in

2011-12 (Table 4). However these BE may differ with the RE and AE. This is an important part of fiscal management whereby an effort has been made to lower the revenue deficit by envisaging a plan for surplus on this account. Budgetary estimates of 2010-11 reveal that the contribution of state taxes, state's non-tax revenue, union excise, grants-in-aid were 38%, 15%, 2%, 45% respectively. As far as the expenditure on revenue account is concerned general services and social services are individually getting double allocation than the economic services. Interest payments comprise 15.3% of the net revenue expenditure in year 2011-12 which is lower by 3.15% over 2010-11 (Table 5). This is also a positive sign whereby an effort has been made to lower the debt servicing charges. Education, sports, art and culture is getting the highest percentage of net revenue expenditure at 22.71% in 2011-12 and that too at an enhanced ratio over 2010-11. On capital account, economic services are getting the maximum of net capital expenditure. However, there is a decline in net capital expenditure from the level of 1760 crore in 2010-11 to 1498 crore in 2011-12 (table 6). This reflects the austerity measures adopted by the state government for the improvement of fiscal position.

State's Debt position

Because of funding of Annual Plans through high levels of borrowings in order to contribute to the required Plan resources, Himachal Pradesh has become one of the most debt stressed States in the country. The financing of our approved 9th and 10th 5 year Plans witnessed an increase in our outstanding debt burden of about Rs. 5,000 crore in 1997 to almost Rs. 20,000 crore at the end of the 10th Five Year Plan. Thus, the high interest payments of about Rs. 1,700 crore per annum in recent years is not because of any fiscal profligacy on the part of the State Government but because of the need to resort to borrowings to fund our Annual Plans and to enable the Government to invest in Capital Expenditure/Capital formation. The State Government recognizes the need to control interest burden and it has been reasonably successful in this respect as evident from the table 7. Percentage of interest payments with respect to total revenue receipts has drastically come down from 32% in 2002-03 to 19% in 2010-11. Though, Interest liability has been projected to increase at an annual growth rate of 12%, the same is quite reasonable given the capital requirements for investments in critical sectors of power, irrigation, roads etc. and the emerging scenario of hardening interest rates, with very little scope for debt swapping, in the future years. The State's Debt to GSDP percentage is one of the highest in the country at 63.8% which is a matter of serious concern. Even in terms of per capita debt, the State has a very high debt level. This high debt is affecting the State's development expenditure as interest and loan repayments pre-empt resources for development.

The State has got into acute debt stress because of the State's weak Revenue base and its inability to contribute to State's Own Resources for funding the State's Annual Plans. There is a need for the Central and State Governments to increase tax base and improve their Tax/GDP and Tax/GSDP ratios so that increase in revenue receipts is sufficient to generate revenue surplus and to keep fiscal deficit within manageable levels. Himachal Pradesh Government is conscious of the need to increase tax and non tax revenues so as to improve the fiscal

situation of the State. Himachal's share in all States' share in Central Taxes continues to be low and has gone down progressively as is evident from the following table 8. Percentage share in grants is also going down since eleventh Finance Commission.

DISCUSSION AND CONCLUSION

The percentage contribution of Primary sectors to total GSDP of the State has declined to 20.74 percent level in 2009-10 from 50.35% in 1980-81. Though there is a tremendous increase in absolute figure but the speedy development of secondary and tertiary sectors has lowered its comparative contribution to state domestic product. Himachal Pradesh being the least urbanized state of India, still keeps its people mainly dependent on agriculture and related pursuits. Though the contribution of the Primary sector in the State Domestic Product has declined but secondary and tertiary Sectors are now competing with each other for dominant share of the economy. However, 57% of the main workers are either cultivators or are agricultural labourers (Census 2001). This indicates the existence of low productivity per worker in the agriculture sector. The Agriculture sector has several challenges in the tough conditions specific to mountainous regions. Irrigation facilities are particularly underdeveloped, with more than 77% of the net sown area in the State being un-irrigated, compared to 61% at the All India level. Clearly, the Government has to intervene to fill critical gaps in accelerating the pace of agricultural development. Industrial activity in Himachal Pradesh is largely concentrated along the area bordering adjoining States of Punjab, Haryana and Uttar Pradesh for obvious reason of better market accessibility. There is very little private investment in the interior areas of the State and this call for appropriate interventions by the Finance Commission, Union Government and the State government.

The State has already achieved impressive expansion in infrastructure facilities such as electrification, banking, post office facilities and tele-density. All the villages of the State are electrified. Per capita consumption of electricity in the State is much higher than the national average. Increased emphasis on Central Sponsored Schemes in the recent past is a positive side of Indian Fiscal System whereby the developmental needs are met through the central government departments which in turn get the allocation through central plan and union budgets. Despite very high costs involved in cutting through difficult terrain to make provisions for all weather roads, Himachal Pradesh has achieved road density of 53 kilometers per 100 square kilometers of area in 2007 against the national average of 106 km. Maintenance of these roads poses a huge challenge in view of adverse weather, hilly terrain and thus a very high maintenance costs. Per capita income of Himachal Pradesh has to be viewed in the context of high cost of living, especially at high altitude. In the mountain areas, the higher consumption requirements increase the cost of living and reduce the taxable capacity of the population, limiting the scope for additional resource mobilization. The tax potential of Himachal Pradesh is further affected by the fact that the major products of the State are primary in nature, on which value added component is much higher at the processing/manufacturing stage, an activity done in industrially advanced States. Taking into account the

watershed, carbon reduction and other ecological benefits, this forest wealth of Himachal Pradesh has been estimated at more than Rs. 1.50 lakh crore. Scientific forest-logging could give us benefits of at least Rs. 1000 crore per annum. But in the National interests, the exploitation of its forest wealth has been legally prohibited by the Court of law. Existing conditions in agriculture and industry in Himachal Pradesh represent some constraints in resource mobilization. High cost of living and high overhead costs further reflect the limitations of state fiscal system. State government is spending a very high proportion of total expenditure on salaries of its employees. Increased pay obligations after pay commission reports further aggravate the financial position of the state. Central assistance through statutory bodies like finance commission has also declined over recent past. Fiscal Responsibility and Management Act and some other fiscal reforms have made the situation tighter for states like Himachal Pradesh who are mostly dependent on central transfers. Recommended ceilings on fiscal deficit have further complicated the situation. Central Governments fully realize the increasing obligations and resource limitations special category states but it need to periodically give a substantial hike in all transfers. Moreover, the states like Himachal Pradesh with a fragile ecology and importance for downstream watershed and environmental effects of national and global importance must get special additional transfers. Though the Thirteenth Finance Commission has acknowledged this aspect but much more needs to be done to enhance the quantum through agencies like planning commission. Furthermore, the

central ministries must facilitate the state government in international funding of the environmental and sustainable development projects.

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